

### **III. Applying Lessons Learned**

These failures teach that Congress and the Commission must continue in their efforts to advance minority ownership. Now that Congress has broken from traditional methods of issuing licenses and moved to the purely capital money-driven system of auctions without fully rectifying the racial imbalance in access to financing (particularly access to the magnitude of financing required to compete in the PCS auction), it is even more important to advance the principle of ownership diversity by protecting and advancing the ability of minorities to obtain licenses.

Congress has provided ample means for the Commission to implement this principle. Congress specifically conditioned the use of a competitive bidding system on "disseminat[ion] [of] licenses among a wide variety of applicants including small businesses, rural telephone companies, and businesses owned by members of minority groups and women . . ."<sup>9</sup> Further, Congress directs the Commission to "ensure that small businesses, rural telephone companies, and businesses owned by minorities and women are given the opportunity to participate in the provision of spectrum-based services. . . ."<sup>10</sup> Importantly, Congress specified that these groups be guaranteed opportunities to provide telecommunications services and not merely to participate in the bidding process.

The Commission's conclusion that bidding credits are "the most cost-effective and efficient means of achieving Congress' objective . . ."<sup>11</sup> is mistaken. As demonstrated by the

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<sup>9</sup>Communications Act of 1934, §§309(j)(2)(B) and (j)(3), (codified as amended at 47 U.S.C. § 309(j)(2)(B) and (j)(3)).

<sup>10</sup>Communications Act of 1934, §309(j)(3) (codified as amended at 47 U.S.C. § 309(j)(3))

<sup>11</sup>Third Report and Order at ¶72.

July 1994 auction, bidding credits do not and cannot sufficiently address financing obstacles nor provide a competitive advantage with regard to the national licenses.

## **RECOMMENDATIONS**

### **1. Activate Reservation Blocks Now.**

Essence believes that, while the recent increase in the bidding credit to 40% represents a favorable step toward effective policy, the bidding credit alone is not the best means of achieving diversity. Essence encourages the Commission to activate immediately the "entrepreneurs' blocks" for the upcoming regional narrowband auctions. Since competitive bidding puts a premium on access to capital, only entrepreneurs' blocks will produce Congress' desired effect. By allowing designated entities to compete amongst themselves for particular licenses, the Commission ensures at least some diversity in ownership.

In the Fifth Report and Order, at ¶¶ 118-121, the Commission has already agreed that "small entities stand little chance of acquiring licenses in broadband auctions if required to bid against existing large companies. . . ." Given the advantages enjoyed by established companies, namely, availability of capital, established infrastructure, and strategic positioning, the Commission has already acknowledged that large firms have the means, and a reason, to outbid others in broadband auctions at almost any cost. Id. To carry out Congress' directive, the Commission has logically concluded that reservation blocks are necessary. Id. at ¶ 121.

Essence believes that the same rationale is applicable to narrowband auctions. All of the same advantages which large companies maintain in the broadband context work to exclude small and minority firms in the narrowband context as well. Even if narrowband licenses draw lower

bids than broadband licenses. large, majority-owned companies can still utilize greater access to capital to raise their bids. In any case, the assumption that narrowband licenses do not present the high barriers that broadband licenses present in terms of initial outlays is erroneous. It was proved erroneous in the July 1994 auction, and the Commission acknowledges this.<sup>12</sup> Because narrowband licenses were auctioned at prices originally expected for broadband licenses, any rules affecting designated entities in broadband auctions should rightly be applied in the narrowband auctions. For broadband, still further changes might be made.

The Commission has established two "entrepreneurs' blocks" for broadband in which large companies will be prohibited from bidding. There is still time to establish "entrepreneurs' blocks" in narrowband. Further, the Commission has promised to apply new knowledge to subsequent auctions and thus, is obligated to consider this option.<sup>13</sup>

## 2. Modify Definition of Minority-Owned Business.

Essence believes that the Commission should use a definition of minority-owned business which includes firms with up to \$75 million in gross revenues. The definition of "minority-owned business" should have been modified upwards commensurate with the unexpectedly high bidding in the July auction.

The original definition included all firms with a net worth of \$6 million or less, or a net income of \$2 million or less. As the Chief Counsel for Advocacy of the U.S. Small Business Administration explained, however, this net worth/net income test "will not include businesses

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<sup>12</sup>Third Memorandum Opinion and Order at ¶40. (quote)

<sup>13</sup>Id.

of sufficient size to survive, much less succeed, in the competitive wireless communication marketplace." Comments, November 10, 1993, p.9. The SBA recommended a gross revenue test and believed that a small business in the telecommunications field should have no more than \$40 million in gross revenue. Nevertheless, the Commission adopted the net worth/net income test. Second Report and Order at ¶ 271.

After the July 1994 auction, however, the Commission realized that the cost of acquiring a narrowband PCS license is significant. Third Memorandum Opinion and Order at ¶ 44. Many other observers were surprised by the high bids.<sup>14</sup> Presumably, the SBA was startled as well. The Commission returned to the issue of defining small business and chose the \$40 million gross revenue test. Third Memorandum Opinion and Order at ¶46. By that point, however, this was an outdated measure. By returning to pre-auction materials for a "new" or "revised" definition, the Commission has not adequately examined this issue.

For an appropriate definition of minority-owned business which takes the new circumstances into account, the Commission need not look further than its issuances since the July auctions. The Commission has recommended "entrepreneurs' blocks" to reserve particular MTA and BTA narrowband licenses and set a maximum of \$125 million in gross revenues for companies to qualify.<sup>15</sup> According to the Commission, the maximum "exclud[es] the large companies that would easily be able to outbid designated entities and frustrate Congress's goal of disseminating licenses among a diversity of licenses. . . ." Third Memorandum Opinion and

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<sup>14</sup>See, e.g., Teresa Riordan, "FCC's Auction Draws Rich Bids: The Audience Gasps at Airwaves Sale," N.Y. Times, July 26, 1994 at D1; Mike Mills, "High Bids Surprise at Auction of Paging Licenses," Wash. Post, July 30, 1994, at A1.

<sup>15</sup>Third Memorandum Opinion and Order at ¶74.

Order at ¶ 83. This rationale can be applied to the regional narrowband auction, if not to create a reservation block, then to isolate the companies that are eligible for and can use other enhancements such as installment financing. Increasing the maximum from \$40 million to \$75 million in gross revenues would work to attract those companies that experience difficulty obtaining financing and capital, but which are sufficiently large to compete and survive in the PCS market.

Funds necessary to pay the high cost of a license are especially difficult to raise because licenses have proven to be "non-assets" for the purposes of financing. Bidders cannot borrow against funds used to purchase the license because of the transfer restrictions placed on them by the Commission. Minority-owned companies are faced not only with the high cost of a license but also the high cost of buildout, estimates for which run as high as 75% of the total. Giving only very small companies an enhancement for an expensive project is thus not logical because the enhancement cannot be used effectively. Thus, the importance of providing bid credits and enhancements to companies large enough to use a license effectively is heightened. For these reasons, Essence recommends and urges that the Commission modify the definition of "minority-owned business" to include firms with up to \$75 million in gross revenues.

In the alternative, Essence requests that the Commission clarify its definition of gross revenues. First, gross revenues should not include commissions and discounts that never pass through a business' account. For example, advertisers in magazines receive a discounted rate for using more page space. As a particular advertiser purchases more space, the publisher receives a lower fee per page. Also, a portion of the fee is paid as a commission directly to advertising agencies who act as brokers. This is revenue for the ad agency. In addition, both

retail and national distributors receive a portion of the magazine's listed price as payment for their services. This is revenue for the distributor. Long-term subscribers regularly pay a lot less than the magazine's listed price. None of these amounts should be counted towards gross revenues of an applicant. Second, accounts receivable should not be included in gross revenues. Again, none of these funds have passed through the applicant's account so long as they remain unpaid.

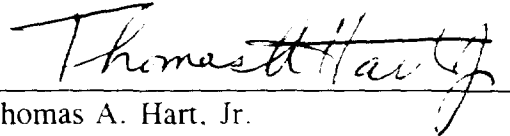
These issues will arise in assessing gross revenue of any broadcast, radio or other media company. The Commission should be sure to estimate the gross revenues of any applicant seeking designated entity status in a conservative manner.

### **CONCLUSION**

The lessons of the past -- including the recent experience of the auction of narrowband licenses -- provide compelling evidence that shows the necessity of immediate changes to enhance the ability of minority-owned businesses to succeed in obtaining PCS licenses in the auction process. Specifically, the Commission should modify the definition of "minority-owned business" to include firms with up to \$75 million in gross revenues for the purpose of the installment payment option. Second, the Commission should activate the entrepreneurs' blocks.

already contemplated for broadband PCS, in the October 1994 Regional Narrowband PCS auction, and in all subsequent PCS auctions.

Respectfully submitted,

A handwritten signature in cursive script, reading "Thomas A. Hart, Jr.", written over a horizontal line.

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